



Testimony of

America's Community Bankers

on

**“Sarbanes-Oxley Section 404: Will the SEC’s and PCAOB’s New Standards
Lower Compliance Costs for Small Companies?”**

before the

Committee on Small Business

of the

United States House of Representatives

On

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Washington, DC**

Chairwoman Velázquez, Ranking member Chabot, and Members of the Committee, I am Diane Casey-Landry, President and CEO of America's Community Bankers¹ (ACB). I am pleased to appear before you today to present our views on Section 404 of the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley") and the compliance costs for small companies in the wake of recently approved standards by the Securities and Exchange Commission (SEC) and the Public Company Accounting and Oversight Board ("PCAOB"). ACB is a national trade association representing the nation's community banks of all charter types and sizes, including state and federally chartered savings institutions and commercial banks. ACB members pursue progressive, entrepreneurial and service-oriented strategies in providing financial services to benefit their customers and communities. Our members represent \$1.7 trillion in assets across the nation and are both stock and mutually owned.

From the outset I would like to thank the Committee for your steadfast advocacy on behalf of small companies and for your efforts to provide relief from the burdens they encounter with Section 404 of Sarbanes-Oxley. ACB supports the regulatory relief provision in H.R. 1869, which would relieve community banks with up to \$1 billion in assets from the costly internal control attestation and audit requirements of Sarbanes-Oxley. We also support H.R. 1508, introduced in the House Financial Services Committee by Representatives Greg Meeks (D-NY) and Tom Feeney (R-FL), which would create an exemption from Section 404 based on company size. Both of these measures take practical steps to clarify the intent and purpose of internal control assessments established in Sarbanes-Oxley.

¹ America's Community Bankers is the national trade association committed to shaping the future of banking by being the innovative industry leader strengthening the competitive position of community banks. To learn more about ACB, visit www.ACB.us.

ACB would also like to commend SEC Chairman Christopher Cox and PCAOB Chairman Mark Olson for the recent action taken by their respective agencies to address the burdens of Section 404 compliance for small companies. The recent interpretive guidance on internal controls approved by the SEC and new auditing standards approved by the PCAOB bring a principles-based approach to the evaluation and assessment of financial reporting and are important achievements that will address many of the burdens that have resulted from Section 404. Although it is too early to tell whether, or to what extent, the new rules will reduce the compliance costs for small public companies, we appreciate the initiative and leadership Chairmen Cox and Olson have demonstrated. While we had hoped for some additional flexibility, particularly in the area of the implementation deadline for non-accelerated filers, the SEC and PCAOB are headed in the right direction, and we look forward to working with them as they continue to identify a middle-ground solution to this complex issue.

Background

Sarbanes-Oxley was a well-intentioned law that was passed to strengthen public company corporate governance and financial disclosure in an effort to restore investor confidence in the public markets. We fully support adequate safeguards to protect the financial safety and soundness for all banks, both public and private. However, ACB has long been concerned that the unintended consequences of Section 404 requirements impose costs and other burdens on public companies of all sizes, without commensurate benefits to investors. This is particularly true with respect to smaller public companies. Moreover, community banks are part of a highly

regulated industry subject to alternative requirements, heightening the need for relief from the unnecessary and duplicative burdens they face.

Publicly held community banks are unique to all other public companies. Community banks are part of a highly regulated industry governed by numerous statutes and regulations covering almost every aspect of banking activity. Banks are subject to statutory and regulatory capital requirements, and each banking institution is regulated by two agencies: the agency that issued the bank's charter and the Federal Deposit Insurance Corporation ("FDIC"). In addition to banking laws and regulations, publicly traded banks also must comply with the SEC's recordkeeping and reporting requirements. No other publicly traded company is subject to the same scrutiny as a publicly traded bank.

Financial Disclosure and Governance for Banks

Even before Sarbanes-Oxley was signed into law, banks had 11 years of experience following a similar regulations designed to protect their safety and soundness. In fact, these regulations served as the initial model for Section 404. Consequently, upon enactment of Sarbanes-Oxley and the SEC's rules implementing Section 404, banks were faced with an additional burden of costs and a second layer of internal controls/financial reporting ("ICFR"). Section 36 of the Federal Deposit Insurance Corporation Improvement Act (FDICIA) of 1991² and Part 363³ of the FDIC's regulations govern bank management's responsibility for financial statements and ICFR. Section 36 requires all banks to have annual financial statements prepared in accordance with generally accepted accounting principles (GAAP) and audited by an independent public

² 12 U.S.C. § 1831m

³ 12 C.F.R. Part 363

accountant. The section also requires each bank to prepare annual management reports signed by the chief executive officer and the chief accounting or chief financial officer that contain a statement of management's responsibilities for 1) preparing the bank's annual financial statements; and 2) establishing and maintaining an adequate control structure and procedures for financial reporting, and for compliance with safety and soundness regulations. Bank management's report is required to be included in the annual report the bank files with the FDIC and its primary federal regulator. These annual reports are available to the public

For banks with over \$1 billion in assets, these regulations also require the management to assess the effectiveness of its internal controls. In addition, for banks with over \$1 billion in assets, the bank's independent public accountant must examine, attest to, and report separately on management's assertion concerning internal controls. The attestation report is also required to be included in the annual report the bank files with the FDIC or its primary regulator. The FDIC concluded that these thresholds would be consistent with the underlying statutory objectives of Section 36 of FDICIA, and ACB has consistently argued that similar thresholds should be sufficient for compliance under Section 404 of Sarbanes-Oxley.

Section 404 Compliance for Non-accelerated Filers

As stated earlier, ACB supports the efforts of the SEC and the PCAOB to improve the implementation of Section 404 of Sarbanes-Oxley, and we applaud the SEC for its recent Management's Guidance and the PCAOB for its revised auditing standard for internal control over financial reporting. However, we are disappointed that in approving the Management Guidance, the SEC decided against a further extension of the compliance dates for non-

accelerated filers despite requests for a delay from both this Committee as well as the Senate Committee on Small Business. Because of the new Management's Guidance and the significant revisions that were made to the auditing standard, ACB strongly believes that the Commission should further delay compliance with Section 404 for non-accelerated filers for a minimum of one year from the current deadlines.

Accelerated filers have had three years of experience with the implementation process and they are best able to incorporate the changes brought about by the Management's Guidance and the revised auditing standard. ACB's members that are non-accelerated filers are very much concerned with the cost and burdens of compliance. These smaller companies are acutely aware of the struggle accelerated filers underwent to implement Section 404, even though these larger companies have significantly more resources and economies of scale. Non-accelerated filers are the companies that can least afford to add personnel, consultants, and systems to comply with Section 404. This is particularly true if the Commission's proposed Management Guidance and the PCAOB's revised auditing standard prove unsuccessful in reducing the costs and other burdens associated with implementing Section 404. ACB appreciates the Chairwoman and Ranking Member's March 12, 2007 letter to SEC Chairman Cox voicing these same concerns, and with the filing deadline just 6 months away, we remain hopeful that additional consideration will be given to this important issue.

The Impact on National and Global Competitiveness

A broader and more deleterious consequence created by Section 404 is the attack on our nation's ability to compete. Strong financial markets are crucial to the health of our nation's economy, and while ours are by far the strongest with regard to transparency and accountability, these safeguards are inadvertently creating a competitive marketplace advantage for Asia, the United Kingdom, and other markets in the European Union where regulatory scrutiny is far less severe and the legal system is not fraught with the same abuse and activism. Sarbanes-Oxley was created to increase waning investor confidence, and to create a more robust environment for foreign investment. But navigating the complexity of the United States' patchwork of regulatory burdens and fear of an increasingly frivolous litigious environment is driving more and more public companies -- and potential investors -- overseas to seek regulatory shelter in a more streamlined environment. The situation is particularly grim from the standpoint of small companies. Generally, companies go public in order to raise capital through public markets. However, the Section 404 compliance costs have caused many companies to either remain or consider going private because the costs associated with being a public company outweigh the benefits.

Competitiveness concerns have an impact on our domestic economy as well. At a time when the outsourcing of jobs overseas is becoming more and more common among large corporations, small companies such as community banks continue to be job incubators on main street America. However, mergers and acquisitions involving community banks are typically motivated by real market pressures, including regulatory burden and unfair competition that is constricting community banks. For example, as of June 1, America's Community Bankers' NASDAQ index

(“ACBQ”)⁴, is comprised of 517 banking companies with a combined market capitalization of \$193 billion. At inception in December 2003, there were 542 companies with a market capitalization of \$170 billion. Each year approximately 50 companies leave the index, primarily because of mergers, but also because of delistings. ACB estimates that as many as 20 percent of ACBQ’s departures are because of a decision to delist, triggered primarily by efforts to reduce the burden created by Sarbanes-Oxley. Additionally, some of the mergers listed Sarbanes-Oxley burden as a contributing factor for the decision to merge, since Sarbanes-Oxley costs are proportionally higher for smaller companies. This does not take into account the missed opportunities for ACBQ since 2003, since the atmosphere for raising capital in the U.S. has gotten increasingly worse, particularly with regard to the cost of going public and the costs associated with compliance for a small public company in the United States.

We urge the SEC to update the Exchange Act’s threshold for registration as a public company from the 500 shareholder level first imposed in 1964. The threshold should be moved to a much higher range in order to provide much-needed regulatory relief for smaller companies that choose to be public, but chose not to be listed on an exchange.

The policies embodied in Sarbanes-Oxley Section 404 have a trickle-down affect into the local economies as well, since community banks that decide to sell or merge with larger regional and national banking organizations will no longer have the presence in local communities beyond their branch offices. We all must work together to ensure that our community banks remain

⁴ The America Community Bankers NASDAQ Index is the most broadly representative stock index for community banks. ACB and the NASDAQ Stock Market launched this Index in December 2003 to track the performance of the strong community-based banking sector.

community banks. Our customers – your constituents – have come to depend on their local community banking institution to provide the best possible service. This comes from years of relationship-building and from living and working in the same communities. Part of achieving this goal is to reduce the amount of unnecessary regulatory burden that is hampering the ability of community banks to compete domestically.

Conclusion

On behalf of ACB and its member banks across the nation, thank you again for the opportunity to appear before you today. We appreciate the work this Committee is doing to ensure that small businesses continue to be engines of economic growth in the United States, and to mitigate some of the unnecessary and burdensome compliance requirements stemming from Section 404 of Sarbanes-Oxley. I would be pleased to answer any questions you may have.